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IN THE

Supreme Court of the United States

October Term 1968

No. 280

UNITED STATES OF AMERICA,
Petitioner,

v.

SKELLY OIL COMPANY,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

PETITION FOR REHEARING

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PETITION FOR REHEARING

Skelly Oil Company, respondent in this proceeding, respectfully petitions under Rule 58 for a rehearing by this Honorable Court of this cause and reconsideration of its opinion herein dated April 21, 1969.

Preliminary Statement

In its opinion, dated April 21, 1969, the Court held that respondent, Skelly Oil Company, in computing its Federal income tax liability for 1958, may not deduct the full amount of $505,536.54 which it was required to repay to customers who purchased its natural gas in the years 1952 through 1957. The Court held that pursuant to the Revenue Code of 1954 the deduction in 1958 must be reduced by the deple-

tion deductions taken in the prior years when the gas was sold and the proceeds included in gross income under claim of right.

Through this petition respondent respectfully urges the Court to grant a rehearing in this case so as to consider the serious Constitutional questions raised by the opinion of April 21, 1969, the previously misapprehended indications of Congressional intent in enacting Section 1341 of the 1954 Revenue Code, and the inevitable conclusion inherent in said opinion, that respondent is entitled to judgment under Section 1341(a)(5) of the Revenue Code.

Reasons for Granting Rehearing

I. The Opinion of the Court Raises Important Constitutional Questions With Regard To Taxation of Property.

In its opinion of April 21, 1969, the Court held that respondent, Skelly Oil Company, was not entitled to a full deduction in 1958 for the $505,536.54 it paid in that year to customers who had purchased natural gas from it in the years 1952 through 1957. The Court held that for deduction purposes in 1958, the amount repaid must be reduced by 27½%, representing the depletion deductions allowed in the prior years when the gas was sold even though no particular provision of the income tax law defining income and prescribing deductions requires such an adjustment. The Court's opinion was that any other approach would be equivalent to allowing Skelly a "double deduction," citing *Charles Ilfeld Co.* v. *Hernandez*, 292 U.S. 62 (1934) and *United States* v. *Ludey*, 274 U.S. 295 (1927). The Court also held that this view did not violate the annual accounting concept of *Burnet* v. *Sanford & Brooks Co.*, 282 U.S. 359 (1931), citing *Arrowsmith* v. *Commissioner*, 344 U.S. 6 (1952).

Respondent, Skelly Oil Company, submits that the *Ilfeld*, *Ludey* and *Arrowsmith* cases have no bearing on, and cannot be cited in context with, the annual accounting concept without raising serious Constitutional questions. Contrary to general assumption, the annual accounting concept for the determination of *income* taxes was not developed for purposes of convenience, nor is it a purely judicial concept or doctrine. It arose because of the Constitutional restrictions imposed upon the levying of direct taxes without apportionment or in accordance with the Census or Enumeration. Constitution of the United States, Article I, Section 2; Article I, Section 9. *Pollock* v. *Farmers Loan & Trust Co.*, 157 U.S. 429 (1895). These restrictions could only be avoided by the Sixteenth Amendment to the Constitution which, in effect, overruled *Pollock* and categorized the income tax as an excise tax within the purview of Article I, Section 8 of the Constitution. *Brushaber* v. *Union Pacific Railroad Co.*, 240 U.S. 1 (1916).

As an *excise* tax, however, the income tax must be levied on an annual basis and on the results of annual operations, and must be determined strictly in accordance with the definitions of income and deductions precisely prescribed by the statute. Therefore, income subject to tax and deductions allowed therefrom are peculiarly creatures of legislation and cannot be "amended" by reference to extrinsic matters without conflicting with the other provisions of the Constitution. See, *Stanton* v. *Baltic Mining Co.*, 240 U.S. 103 (1916); *Stratton's Independence* v. *Howbert*, 231 U.S. 399 (1913). As the Court pointed out in *Brushaber*, the Sixteenth Amendment merely relieved the income tax from the burden of reference to the source of the income subjected to the tax (240 U.S. 1 at 19), thus constituting the income tax a true excise subject only to the Constitutional requirements of uniformity of application and a determination thereof strictly as legislated by the Congress. *Burnet* v. *Thompson Oil & Gas Co.*, 283 U.S. 301 (1931). Adjustment of the specified categories of income or other-

wise allowable deductions of a taxable year by reference to events of prior or subsequent years takes the question out of the category of "excise" and raises the question of the *source* of the income or deductions involved, and the resulting Constitutional questions of the direct taxation of property without apportionment. This is the rationale and sole justification for the decisions of this Court in *Ilfeld, Ludey* and *Arrowsmith,* wherein the inquiry was whether property was being taxed without apportionment upon its final disposal by sale or liquidation. See, *Burnet* v. *Thompson Oil & Gas Co., supra,* at pages 306-308. See also, *Burnet* v. *Whitehouse,* 283 U.S. 148 (1931) and *Burnet* v. *Logan,* 283 U.S. 404 (1931).

This Constitutional limitation is precisely the reason why the Congress has always provided that the tax impact of the depletion deduction for minerals and all other deductions must be determined on an annual basis by reference to the *operations* of that year regardless of prior or subsequent events. To allow otherwise would raise the Constitutional questions of the taxation of propery or capital. *Eisner* v. *Macomber,* 252 U.S. 189 (1920). See, *Penn Mutual Indemnity Co.* v. *Commissioner,* 32 TC 653 at 659-667 (1959) and d., 277 F.2d 16 (CA 3rd, 1960).

In the instant case, respondent, Skelly Oil Company, has been doubly penalized. Its mineral is gone and the money has been paid out. No other taxpayer has been so subjected to the deprivation of its mineral and the loss of its money. As compared to taxpayers who produced and sold depletable minerals in the taxable years 1952 through 1957, and were not forced to refund part of the purchase price, Skelly has been discriminated against and its property taxed without reference to the Constitutional requirements of apportionment or enumeration. It is unconstitutional for the Court to go outside the provisions of the law to levy an additional *income* tax on Skelly for 1958 by denying it a proper deduction specifically sanctioned by Congress, and,

in effect, tax as income an amount not realized in the taxable year. *Eisner* v. *Macomber, supra.* To do so, in substance, amounts to the taxation of property. In this case the issue has been treated as if dollars had been depleted rather than the mineral reserve.

The opinion of the Court has failed to apply the clear and unambiguous provisions of the income tax law and thus has unconstitutionally deprived respondent of its property without due process of law. It has nullified the entire subsection 1341(a)(4) of the 1954 Revenue Code, a nullification which the Constitution specifically prohibits so long as only Article I, Section 8, is invoked.

With particular reference to the *Arrowsmith* case, it should be noted that there the taxpayer was *allowed* a deduction precisely commensurate with the amount previously included in "gross income"—the measure of the tax, and the taxing power, provided by the Constitution and the Sixteenth Amendment thereto, and precisely the standard continued in the Revenue Code by Congress when it enacted Section 1341.

II. The Adjustment of the Deduction For 1958 By the Amount of Depletion Sustained in Prior Years is Unconstitutional.

In its opinion of April 21, 1969, the Court held that the deduction for 1958 must be adjusted to conform with the amount taxed when the money was originally received on the grounds that 27½% of said receipts were "in reality tax exempt." Respondent, Skelly Oil Company, submits that the proceeds from the sale of gas in the prior years were not tax exempt to the extent of 27½%, but rather that 27½% thereof was allowed as a deduction for those particular years under the provisions of the Internal Revenue Code. Once those years were closed, however, and the taxes with regard thereto finalized, the previously allowed deple-

tion deduction became part of respondent's recovered capital and no provision of the law permits the adjustment thereof. *Burnet* v. *Thompson Oil & Gas Co., supra.* To do so conflicts with the Constitution. The Treasury Regulations have recognized this restriction and have always maintained that depletion deductions may not be adjusted, at law or in equity, after the close of the taxable year or years when they were properly allowed.

In its opinion the Court stated that "We cannot believe that Congress intended to give taxpayers a deduction for refunding money that was not taxed when received." Respondent submits that the statute as written does not predicate the deduction, allowed by the express provisions of the Internal Revenue Code, upon the *taxing* of the income when received. Congress could not have so intended because to do so would have removed the item in question from the purview of Article I, Section 8, and placed it within the scope of Article I, Sections 2 and 9, and thus subject it to the restrictions imposed by those sections. Even Section 1341(a)(5) does not permit the tax liability for a prior year to be recomputed and *reimposed.* Adjustments may only be made in the current year's tax by reference to the prior year's computation. Subsection (a)(5) prescribes the computation of the tax for the *current* year. It provides that any reduction in tax for a prior year due to an exclusion from gross income for that year will serve to reduce the *current* year's tax—a tax credit. To provide otherwise would violate the annual accounting requirement of the statute and would be unconstitutional!

The Court, however, has in its opinion required respondent to do what even the Congress cannot constitutionally require—reopen prior years in order to compute the tax for the current year by disallowing deductions taken in those prior years to which the respondent was and is rightfully entitled. There is a serious question as to

whether Congress itself could constitutionally require by statute that a current deduction, otherwise allowable, must be reduced by reference to the tax ramifications of a prior year, or whether Congress itself could constitutionally deprive a taxpayer of a deduction taken in a prior year to which it was rightfully entitled when taken.

III. The Opinion of the Court Disregards the Specifically Stated Intention of Congress.

In its opinion, dated April 21, 1969, the Court stated as grounds for its decision that "(h)ere, the taxpayer always wins and the Government always loses. We cannot believe that Congress would have intended such an inequitable result." Regardless of the question of whether any equitable principles are applicable in the operation of the tax law (see *McGinty* v. *Commissioner*, 325 F.2d 820 (CA 2nd, 1963)), this view is diametrically opposite to the precise language of the statute, the Regulations and the Congressional Committee Reports. The Committee Reports specifically state that a taxpayer using Section 1341 must reduce his tax for the year of restoration by *either* the tax attributable to the deduction, *or* the decrease in the prior year's tax attributable to the removal of the item, "whichever is greater." H. Rept. No. 1337, 83d Cong. 2d Sess. (1954), p. A294; Sen. Rept. No. 1622, 83d Cong. 2d Sess. (1954), p. 451.

Section 1341(a)(3) of the 1954 Revenue Code specifically provides that the tax for the taxable year shall be the *lesser* of either the tax computed with a current deduction or a recomputation of the prior year's tax after excluding the amount restored from gross income.

Thus, Congress in enacting the legislation clearly stated that the taxpayer *must* always win and the Government *must* always lose when Section 1341 is applied. If it now

appears that the amount of money involved may be too large, the Congress alone may supply the remedy.

Despite the Court's statement (Opinion, pp. 7, 8) that "* * * no attempt is being made to require the tax savings from the deduction to equal the tax consequences of the receipts in prior years," that is precisely what has been held from a pure mathematical standpoint. Unless some other factor, such as a change in tax rates, intervenes, under the Court's opinion the mathematical effect will *always* be tax equalization. Congress refused to legislate this very proposition. This is the weakness of the *proposed* Treasury Regulation cited by the Court, and is contrary to the intent and purpose of Congress which can be strict or lavish in its definition of income or allowance of deduction *for a taxable year*. *Lewyt Corp.* v. *Commissioner*, 349 U.S. 237 (1955).

It has always been axiomatic in the application of the tax laws, which have no genesis in common or natural law, that the precise terms of the taxing statutes must be applied as written. If there is any room for equity in the tax law, this is the only equitable principle which can apply. *Cf. D. B. Anders* v. *Commissioner*, 48 T.C. 815, at 820-823 (1967). To allow the subjective views or unilateral interpretations of the tax collector, or the Courts, to become paramount to the statutory provisions is to destroy the validity, relevancy and credibility of the self-assessment method of revenue collection which heretofore has been the distinctive cornerstone of the United States revenue system.

No philosophical "double deduction" exists where two separate deductions, for separate purposes, are allowed under separate provisions of the Revenue Code. *D. B. Anders* v. *Commissioner, supra.* To determine each year's tax by reference to prior or subsequent events or years, and justify the reference by an alleged need to avoid a "double deduction", is to ignore the entire scheme of the Revenue Code and constitute partisan expediency the mother of taxation.

The overwhelming thrust of the Court's opinion of April 21, 1969, is that there is some nebulous standard of fairness or equity which overrides the terms of the tax statutes whenever the tax collector feels that the statute as written provides excessive benefits to taxpayers. Thus the even-handed policy expressed in *Lewyt Corp.* v. *Commissioner, supra,* at 240, has been revoked *in silentio,* and taxpayers may no longer claim the protection of clear statutory provisions if the *Government* poses an objection. At the same time, the Court, by citing *Alice Phelan Sullivan Corp.* v. *United States,* 381 F. 2d 399 (Ct. Cls. 1967), with approval has reaffirmed the teachings of *Healy* v. *Commissioner,* 345 U.S. 278 (1953), and *United States* v. *Lewis,* 340 U.S. 590 (1951), that the statute must be strictly applied as enacted when the detriment falls upon the *taxpayer.* If it is now the law that taxpayers may not rely upon the express provisions of the tax law in calculating their allowance to the sovereign, that fact should be clearly enunciated. The sword of taxation has historically been double-edged—if one edge is now to be dulled, taxpayers are entitled to know about it in clear and certain terms, or this Court should henceforth be prepared to review all tax cases where the Government deems the equities sufficient to withhold the statute in its favor.

The very fact that the Court's opinion points out that the adjustment therein mandated will "affect only a few cases" indicates the existence of a Constitutional question with regard to the appropriateness of the required adjustment even under the broad income-excise tax scope of Article I, Section 8 of the Constitution, which requires that under that provision, the exercise of the power must be uniform in its application. Uniformity of application would seem to require that one taxpayer, one class of taxpayer, or one type of industry not be discriminated against in the application of a taxing statute.

IV. The Opinion of The Court Requires The Application of Section 1341(a)(5) of The Internal Revenue Code of 1954 and Thus Affirmance of the Judgment Below.

In its opinion of April 21, 1969, the Court held that the amount of the "deduction" referred to in Section 1341(a)(4) of the Revenue Code of 1954 need not "necessarily" be equal to the "item" previously included in gross income mentioned in Section 1341(a)(1) and, thus, that the amount of the deduction under 1341(a)(4) must be determined by reference to the other sections of the Code. Apparently the Court felt that the stipulation of the parties that Section 1341(a)(5) does not apply to this case precluded reference to that subsection in ascertaining the intention of Congress in enacting Section 1341. (Opinion, p. 4) Respondent submits that the parties stipulated that Section 1341(a)(5) does not apply in determining respondent's tax liability for 1958, but did not stipulate that the intent of Congress is not manifested by that section of the Code. Reference to Section 1341(a)(5) demonstrates conclusively that in enacting Section 1341, the Congress used the terms "item" and "deduction" interchangeably. If this is not so there is a serious question as to the amount of the "item" previously included in gross income for purposes of determining the application of Section 1341(a)(5) which provides for the determination of the reduction in tax thereunder by reference to "an amount equal to the tax for the taxable year computed without *such deduction,* minus *** the decrease in tax *** which would result *solely* from the exclusion of such *item* *** from gross income for such prior taxable year (or years)." (Emphasis supplied.) It is absolutely clear here that if the "deduction" is not the same as the "item" previously included, then the tax must be computed under Section 1341(a)(5) by reference to an excluded amount which is, under the Court's opinion, not necessarily

the same as the amount deductible under Section 1341 (a)(4). To put it another way, if, under the Court's opinion, the current year deduction must be reduced by the application of other Code sections, the excluded *item* cannot be so adjusted under the "double deduction" theory. As the Court correctly points out, the term "item" is first mentioned in Section 1341(a)(1) and is the "item" included in "gross income" in the year of receipt. (Opinion, p. 5) The "item" previously included in "gross income" is the full proceeds of the sale of the mineral and that "item" must be excluded under Section 1341(a)(5). Accordingly, pursuant to the Court's opinion, Section 1341(a)(5) provides the greater benefit and it is mandatory that the subsection be applied regardless of the stipulation between the parties. The Court should have so held.

If the stipulations of the parties are to be binding in the premises, the record shows that the parties stipulated the issue to be whether Section 1341(a)(4) requires an adjustment for depletion of the "otherwise allowable deduction" for the amount repaid in 1958. The Government thus conceded long ago that "other portions" of the Revenue Code do not require the adjustment now mandated by the Court. As this Court has held that Section 1341 (a)(4) itself does not require the adjustment, the opinion should uphold the respondent.

CONCLUSION

In accordance with the foregoing, it is respectfully requested that this Petition for Rehearing be granted and the questions discussed herein be set down for hearing and briefing by the parties.

Respectfully submitted,

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Certificate of Counsel

I hereby certify that I am counsel for respondent in the above-entitled cause and that the foregoing Petition for Rehearing is presented in good faith and not for delay.

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